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RI01-37Y	IBM CORPORATION - ISSC, Lintner, W. D.	1
RI01-9	IBM - ADVANTIS, Meininger, Charlie	1
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ZINTERCOP	Z.., Smith, G. Chris	1
ZINTERCOZ1	Z..CALIFORNIA INTERNAL, Parks, Judy	20
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November, 1993

Dear Colleague:

Enclosed please find the report, *Business Operations Outsourcing*, issued as part of INPUT's Outsourcing Information Systems Program.

The findings and analyses within the report are based on research conducted earlier this year. It examines the emergence of business operation outsourcing, an area of increasing interest to both vendors and clients. Under such an outsourcing arrangement, the vendor assumes management of an entire business process for the client, applying technology to solving the problem as needed.

Current clients of outsourcing vendors will find this report useful in considering which processes to outsource next. Vendors can assess their capabilities and determine how to better serve this expanding market need.

If you have any questions or comments on this report, please do not hesitate to call.

Sincerely,

Bob Goodwin

Robert L. Goodwin
Vice President

Enclosure

OCTOBER 1993

BUSINESS OPERATIONS OUTSOURCING

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Abstract

This report, entitled *Business Operations Outsourcing*, examines the potential market in the U.S. for the outsourcing of entire business operations to a vendor. The concept is first defined clearly, then some observations derived from the research on this topic are presented.

The business operations outsourcing market has the potential to grow at a compound annual growth rate (CAGR) of 28% over the next five years—considerably faster than the overall market for outsourcing.

INPUT has identified several vertical markets that have the most potential for this type of outsourcing. Examples of specific business operations already being outsourced, as well as the vendors that are doing this type of outsourcing, are also identified. The three types of outsourced business operations discussed in this report are document management, claims management and client service.

The major characteristics of business operations that make them good candidates for outsourcing are identified and discussed. These findings are based on data gathered from both user organizations and vendors.

The effect on this market of the significant IS market factors, client/server architecture, electronic commerce and business process re-engineering is discussed.

This report contains 62 pages and 21 exhibits. It was prepared as part of INPUT's Outsourcing Information Systems Program.

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Outsourcing Information Systems Program
(OSP)

Business Operations Outsourcing

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Introduction

Business operations outsourcing is the next logical step in the outsourcing equation for many vendors and for many of their clients already doing some outsourcing. INPUT defines business operations outsourcing as turning over management of an entire business process in the organization to a vendor. That process may include financial operations, the human resources function or other production operations.

A further stipulation in the INPUT definition is that the process must contain at least a 30% IT (information technology) content. This is to eliminate some business processes that have been outsourced for a long time, such as catering, landscaping services or security and protective services. Business operations outsourcing is not really new, but as business organizations become more comfortable with turning over information services operations to vendors, they naturally begin to extend outsourcing to other business processes.

The boundary between IS and non-IS operations will become increasingly blurred within organizations. Exhibit I-1 illustrates how the boundary is shifting to include more business activity. Eventually the distinction between an IS activity and a business activity will be very difficult to make. At that point, the role of the vendor will be to manage business operations, not systems operations.

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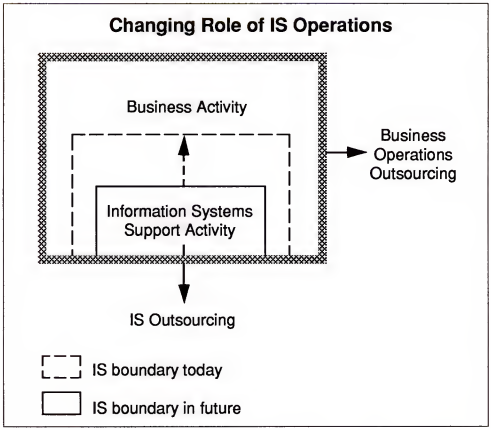
EXHIBIT I-1



A
Objectives

The purpose of this study is to examine the market potential for business operations outsourcing. It will also examine the directions the outsourcing market will take as it expands to include more business functions as part of vendors' responsibility. The research explores what the client expects to get from the vendor, which operations are the likeliest candidates for outsourcing and what the vendors are doing to prepare for this emerging market.

Any vendor who currently provides outsourcing services—systems operations in either of its forms, platform operations and applications operations, applications management, desktop services or network management—will find the information in this report of value. Traditional processing vendors who see a need to expand their markets may also find the insights in this report helpful in assessing how to change their operations to meet changing outsourcing market needs.

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B
Scope and Use

Vendors currently in the outsourcing market will be interested in seeing how the overall market will evolve as entire processes are increasingly turned over to vendors for their management and execution. These vendors must decide if the outsourcing market is one they wish to enter and whether they are prepared to enter it now or will need to change their current practices.

More specialized processing or operations vendors will be able to determine if they really are in this market already. They can then use the information in this report to decide how to change their operations to increase the scope of their outsourcing activity or maintain their involvement at the specialized functional level only.

C
Methodology

Because there are only a limited number of examples of business operations outsourcing in the current marketplace, vendor candidates did not need to be currently responsible for client business processes to be candidates for interviews. Thus, a good sampling of the current outsourcing vendors was contacted and interviewed. Some vendors who specialize in only one function, such as document management, were also interviewed, even though they are not considered traditional outsourcing vendors. The scope of the outsourcing marketplace is increasing and INPUT's research in the market must expand correspondingly.

User respondents need to be more aware of the possibilities of business operations outsourcing. Though the questionnaire was designed to solicit responses from potential users—not only those currently outsourcing operations to vendors—users were more reluctant to respond and therefore the set of user responses is more limited.

The questionnaires used in each case—for users and vendors—were similar; they are included in Appendix A of this report. The questionnaires were designed to solicit general impressions and opinions about the characteristics of a business operation that is a good candidate for outsourcing , not just to report on a user's experience with business operations outsourcing.

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D
Related INPUT Reports

Systems Operations Buyer Issues and Alternatives (1991)

Systems Management Priorities and Directions (1991)

Methods of Approaching IS Outsourcing (1992)

Outsourcing of Network Management and Operations (1992)

Strategic Assessment of the IS Outsourcing Revolution (1992)

Outsourcing Desktop Services (1992)

Interaction of Downsizing with Outsourcing (1992)

IS Outsourcing Market Opportunities, 1992-1997 (1992)

Information Systems Outsourcing—Competitive Analysis (1993)

Outsourcing Awards Analysis (1993)

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Executive Overview

Business operations outsourcing is when an organization turns over one or more of its business operations to a vendor to be managed. Such management can include responsibility for the staff conducting the operation, the facility in which the operation is housed, and the information technology and communications infrastructure needed to make that operation work effectively.

The concept is not a new one. It has roots in facilities management and processing services, both of which have been significant components of the information services industry for many years. What is new is the evolution of these activities into true outsourcing arrangements, in which the vendor assumes more management responsibility than in the past, at increased risk for the vendor.

A
Purpose

INPUT's research into this emerging segment of the IS outsourcing market explores what clients expect to derive from their relationship with outsourcing vendors. It does this by identifying the characteristics of an operation that make it a good candidate for outsourcing, and the attributes of a desirable operations outsourcing vendor.

This information is of interest to both parties in the relationship. Vendors will need to assess how their current organizations are structured to respond to this developing market need. User organizations will need to make an informed judgment as to whether this model of outsourcing is the right choice for them. They can also use the research findings to identify operations that might be best outsourced to their vendor of choice.

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B
Research Findings

The observations and conclusions derived from the research indicate that there is a growing market demand for the all-inclusive type of outsourcing arrangement that business operations outsourcing represents. A number of these arrangements already exist in the marketplace and serve as good models for how the relationship can work.

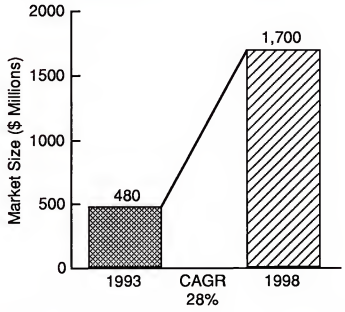
The data is presented first at the overall market level. The market size and potential are estimated. Then the user organization's motivations and objectives are studied. Finally, the perspective of IS vendors is reviewed. Vendors who participated in the study included both traditional outsourcing vendors and some non-traditional ones who have established a market for themselves in providing specialized functions.

1. Market Potential

INPUT expects the business operations outsourcing market to grow from a current revenue level of $480 million in 1993 to $1.7 billion in 1998. This represents a compound annual growth rate (CAGR) of 28%, with much of that growth coming in the latter two years of the forecast period. The business operations outsourcing market as currently measured is only 4% of the total outsourcing market.

EXHIBIT II-1

Business Operations Outsourcing—Market Forecast, 1993-1998



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This growth rate is somewhat higher than that for the IS outsourcing market as a whole, which is growing at a CAGR of 16% over the same period, according to INPUT's latest estimates.

Several vertical industries were identified as having the highest potential for growth in business operations outsourcing arrangements. The three vertical markets with the greatest potential are identified in Exhibit II-2. The potential score was derived by considering the size of the current outsourcing market for each industry, the overall growth rate for the vertical market, and the perceived receptivity for business operations outsourcing.

EXHIBIT II-2

Business Operations Outsourcing— Key Vertical Markets

Industry	Potential Composite Rank
Banking/Finance	19
Health Services	18
Insurance	16

Banking and finance ranked high because of the current penetration of the outsourcing arrangement in the banking community in particular and the relative comfort of the market with outsourcing in general. There does seem to be a slowing down of new contracts in this market this year, but the consolidation should result in more activity in the future.

The health care and insurance vertical markets are both considered to have high potential because of the already high level of activity with vendors, in the claims processing area in particular. There are notable differences in the two markets, however.

The health care market is driven by cost reduction motives and the need to enhance technology in business operations. Both factors are strong drivers for business operations outsourcing.

The insurance industry has always been reluctant to outsource any of its IS functions. Yet the industry is already using vendors for health claims processing, particularly the Blue Cross providers. Usually quick to adopt new technologies, insurance companies are nevertheless feeling strong cost pressures this year and are becoming more interested in outsourcing arrangements.

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The types of operations that are the best candidates for outsourcing were identified by the survey participants. These operations can be classified as those having a customer focus or external orientation, and those having an organizational focus or internal orientation. Exhibit II-3 gives examples in each group.

EXHIBIT II-3

Business Operations Groups

Customer Focus	Organization Focus
Client Service	Payroll
Claims Management	Payables/Receivables
Direct Marketing	Bulletin Boards
Warranty Administration	Inventory Management
Order Processing	Engineering/Design

INPUT's research indicated that user organizations were more likely to outsource the externally focused activities, such as client service, claims management and warranty administration. Many of these are labor and IT intensive, yet they are critical to the well-being of the organization. By staffing these activities with vendor personnel, organizations have less direct interaction with their customers, but claim that the increased efficiency of the response system that results is worth such a trade-off.

2. User/Client Environment

During its research, INPUT identified three types of business operations that were already being outsourced:

- Document management—The vendor manages the design, printing and distribution of marketing materials, including mailing list management.
- Claims management—The vendor manages the processing of insurance claims, including interfacing with the claimants to answer questions. In some cases, the vendor also acts as the fiscal agent, actually disbursing the cash payments.
- Client service—The vendor manages the hotline or call-in facility that interfaces directly with the consumer of the organization's products. Vendor personnel actually resolve the consumer's problems on behalf of the client organization.

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Survey participants were asked which characteristics were the most important in determining whether an operation is a good candidate for outsourcing. The top three characteristics are identified in Exhibit II-4.

EXHIBIT II-4

Business Operations Outsourcing—
Key Characteristics of Candidate Operations

Characteristic	Rating
Labor Intensive	4.1
High Technology Content	4.1
Common to Client's Industry	4.0

A labor-intensive process is a good candidate for outsourcing because of cost savings considerations. It was stated that the vendor can apply technology to reduce the labor content in many cases. The vendor at least can apply experience and methodology to the management of large staffs.

A process that depends on high technology is a good candidate for outsourcing because of the lack of technical skills in the user's internal organization. The user organization would rather use the vendor to leverage the technology it needs than make a long-term investment in it. Users must be convinced, however, that the vendor can indeed implement the high technology application successfully.

If a process is common to all participants in one industry, it probably does not convey a competitive advantage to the firm that does it more efficiently. For that reason, clients are more prepared to outsource these operations than those that they can hone into a competitive advantage.

3. Vendor Perspectives

Nine of the twelve vendor respondents to the INPUT survey stated that they are already doing a small amount of business operations outsourcing. The proportion of their revenue derived from these arrangements ranged from 2% to 10% of their total outsourcing revenues.

When the same vendors were asked when certain business operations would be outsourced, they responded as shown in Exhibit II-5.

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EXHIBIT II-5

Timing of Outsourced Operations

Operation	When	Number of Respondents
Customer Service	now	3
Direct Marketing	now	3
Claims Processing	now	2
Payables/Billing	1-2 yrs.	6
Personnel Management	1-2 yrs.	4
Warranty Administration	1-2 yrs.	3

The list above includes all of the operations that received multiple responses. Note that the vendors would only commit to the next two years, commenting in some cases that they could not predict what would happen after that.

C
Recommendations

Three key market factors were identified as most likely to influence the growth of the market for business operations outsourcing in the coming years. These are summarized in Exhibit II- 6.

EXHIBIT II-6

Key Market Factors

- Client/server platforms
- Electronic commerce
- Business re-engineering

As client/servers emerge as the platform of choice in more and more business operations, management will make a significant discovery. It will become evident that the management of a suite of PCs and workstations along with their associated LANs and WANs is a much greater challenge than managing a centralized data center. In fact, the PC is a data center on a desk, with many of the same management issues and many fewer management methods. Business operations outsourcing offers a viable solution to that problem.

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Electronic commerce, really an example of business operations outsourcing when the service is provided by a VAN provider, will increasingly cross trading partner lines in the future. As ordering by interactive TV and electronic bill payment spreads to the consumer community, there will be a need for third-party suppliers to provide the infrastructure to keep track of these millions of transactions and process them efficiently. Processing will expand beyond the ability of any single user organization to perform.

Business process re-engineering proponents are increasingly finding that the operations with the greatest potential for performance improvement of the organization as a whole are the externally focused activities. These are the very activities that this survey has identified as good candidates for outsourcing. Thus client service, warranty administration, and claims management are operations that could cause the market for business operations outsourcing to grow at a faster rate than is currently projected. A limiting factor is the rapidity with which these activities can be re-engineered in enough companies to make the demand increase. The re-engineering process itself can, after all, take several years.

In conclusion, INPUT expects the business operations outsourcing market to grow at a slightly faster rate than the outsourcing market as a whole in the short term. This new outsourcing arrangement will expand as the comfort level of both users and vendors increases.

Users will have to find vendors who can function as partners, sharing in decisions and strategy development. These are not qualities that can be measured with rigid metrics; they require some reasoned evaluation on the part of the user organization's management team.

Vendors will have to build reputations as being organizations able to get the client's job done under any circumstances, and be willing to share risks with that client. This situation creates a challenge for the vendor management team: to manage risk and balance its bottom line against the best interests of the client.

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Market Forecast

INPUT's research into the business operations market identified a number of existing activities that traditional and nontraditional vendors are managing for clients that can be classified as business operations outsourcing. In fact, some segments of this market have been included as part of the outsourcing market for some years under the guise of platform operations or applications operations. Other segments traditionally have been considered processing services activities that have been expanded in the last few years as vendors assume more management responsibilities for the client.

A
1993-1998 Forecast

Business operations outsourcing is an evolutionary arrangement that has its roots in both the processing services and systems operations service modes. As mentioned earlier, the client turns over management of an entire business operation to a vendor, who performs it as an integral part of the client's business.

To measure the market for this mode of outsourcing, vendors' estimates of their own revenue mixes and users' buying intentions were polled. INPUT found pockets of business operations outsourcing beginning to form already and expects the market to expand greatly in the next five years.

INPUT estimates that the market for business operations outsourcing is approximately $480 million in 1993, as shown in Exhibit III-1. The market is projected to grow at a compound annual growth rate of 28% over the five-year period from 1993 to 1998. Much of the growth is anticipated to occur in the last two years of the forecast period. This is faster than the growth rate for outsourcing as a whole, which is currently growing at 16%, in INPUT's perspective. This will result in a $1.7 billion market for business operations outsourcing by 1998.

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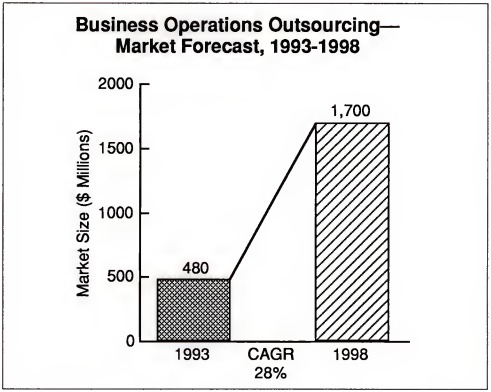
EXHIBIT III-1



This preliminary forecast could be revised significantly upward as a result of two market trends that INPUT is currently tracking.

- The rapid increase in the use of client/server architectures as the platform of choice for IS applications will impact the rate of growth significantly. The new technologies involved and the interconnected PCs and workstations are actually more difficult to manage than a traditional data center operation.

- The expansion of EDI and electronic commerce into related operations will serve a 'gating' function also. As electronic commerce begins to connect disparate organizations, a neutral vendor will be better suited to manage the operation than one of the significant members of a particular trading community.

Both of these factors are discussed further in Section C of this chapter.

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B

Leading Business Operations Markets

The revenue generated by business operations outsourcing still represents a mere 4% percent of the total market for outsourcing in 1993. That entire market is estimated to be $12 billion for 1993, and will more than double to $25.7 billion by 1998.

1. Industry Potential

Because business operations outsourcing is such a small segment, it is not feasible to quantitatively separate this revenue estimate into either industry breakdowns or application types. INPUT's research does allow for qualitatively identifying vertical industries likely to show the most revenue potential in this type of outsourcing. The potential is based on a composite of the growth projections for the industry in the outsourcing market in general and the receptivity of that industry to outsourcing business operations, as identified in INPUT research. Exhibit III-2 summarizes this growth potential.

EXHIBIT III-2

Business Operations Outsourcing—Growth Potential in Key Vertical Markets

Industry	Composite Score
Banking/Finance	19
Health Services	18
Insurance	16
State/Local Government	15
Retail	14

The composite score was derived by factoring the industry's total outsourcing revenue, the growth potential of that industry and the perceived receptivity to business operations outsourcing. This method is an attempt to identify where the largest revenue potential really is, not just where there is likely to be the most interest.

The banking/finance vertical market has business operations outsourcing potential both by virtue of the current size of the market and the frequent mention of this market by the survey participants. As is evident, banking and finance did not get as many mentions as some other industries (see Chapter V), but it is a large, mature market for outsourcing.

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Users in this market tend to understand clearly what outsourcing can do for them, have become more adept at managing the outsourcing relationship, and should be more willing to outsource entire operations, assuming they have been happy with the relationship. In fact, banks do outsource check processing in many cases, and use third parties to provide funds repository (lockbox) services. The industry as a whole is recovering from the difficult financial straits it was in two years ago, but the experience has left bankers more alert to controlling costs. Banking is a receptive environment for the business operations outsourcing arrangement.

The health services market ranked almost as high as banking in the composite score, even though its revenue is currently a much smaller segment of overall outsourcing market revenue. The health services market is estimated at $1.2 billion in 1993; banking market revenue is estimated at $2.8 billion for the same year.

Two factors are contributing to this high potential score. First, there is a requirement to reduce costs significantly and rapidly. This requirement coincides with demand by the community for more new services and treatments (AIDS care and geriatric treatment). The health care community is caught between the need to provide more services and still operate more cost effectively. Many health care companies are working in groups and turning to outsourcers for solutions. Second, there are already many cases of business operations outsourcing contracts in the health care community. Of nearly 7,000 hospitals in the U.S., 550 are managed by contract management firms. That number will grow in the next few years. Hospital Management Corp. and Quorum Health Group are examples of firms that manage hospitals under contract.

A number of individual functions are already being provided by external contractors. Typical of these are:

- Diagnostic imaging (Image America)
- Claims processing (SSI)
- Laboratory work (MedPath)

Thus, the industry is accustomed to turning over management of non-core functions to a variety of third-party operators. Though this pattern may continue, there are still many hospitals, HMOs or doctors' practice groups that manage their business operations themselves. Opportunities for outsourcing vendors abound because of the cost pressures and the relative comfort that the health care industry has with turning over operations to vendor management.

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The insurance vertical market rated high in potential primarily because of the extensive claims processing activity already being done. Though many insurance companies traditionally have been reluctant to outsource their entire data center operations, they are more willing to let the claims processing activity be managed by a third party. This is particularly true of medical claims processing activities and does not apply as yet to property and casualty companies.

These claims processing arrangements typically started out as processing services arrangements. Many of them still are, but more of them now include claimant interface and even payment disbursement activities. EDS, ISSC, CSC and GTE Data Services all have some of the Blue Cross medical insurance carriers as clients. For vendors such as Shared Medical, SSI and Continuum, the claims processing component of their business represents at least 50% of their entire revenue base.

The public sector market represented here by the state and local government vertical industry has much the same incentive to outsource business operations as does the insurance vertical industry. It is the Medicaid/ Medicare claims process as well as the entitlement programs that need to be managed.

The federal government has passed on responsibility for administration of the food stamp, aid to dependent children and Medicare/Medicaid programs to the individual states. In most cases, states are not prepared to provide the IT capabilities that these programs need to function efficiently. More states and municipalities are turning to IS vendors for the technology and expertise to manage these operations.

EDS, CSC and SHL Systemhouse have been particularly effective in acquiring some of these contracts. Many other contracts are being managed by local or regional service providers, however.

Finally, the retail vertical industry has two characteristics that give it high potential for business operations outsourcing. First, the profit margins in that sector of the economy continue to be very thin. That has been the historical pattern in much of this industry and is expected to continue. The successful firms are those who know how to make information work to their advantage. Those who use point of sale (POS) data to track inventory on a daily basis can control their costs. Those who can acquire a new supply of a fast-moving item within 24 hours can benefit from changes in consumer tastes. This generally requires sophisticated technology in which not all firms can invest.

Second, there are success stories of the application of technology to improve an organization's performance. The classic tales we all hear about Wal-mart have parallels in such chains as Home Depot and The Limited. Retail firms are thus receptive to the application of management

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tools implemented by new technology, such as EDI and JIT inventory tracking. This combination of improved cost control and profits by the judicious application of technology is the very motivation that has induced other outsourcing clients to enter such arrangements.

The other vertical industries that were mentioned by the respondents rated ten or below in this scale, so are not considered high-potential markets now. The discrete manufacturing industry may be an exception because a significant increase in the use of outsourcing vendors to manage customer functions, identified in only two isolated cases so far, will greatly increase the potential for business operations outsourcing in this market.

2. Operations Types

The market can be examined from another perspective. Several business operations have already been identified as outsourced functions. Currently these are the document management, claims management and client service functions. Other likely candidates for outsourcing include personnel management, warranty programs, information directories, payroll and payables/receivables.

Exhibit III-3 groups these operations into types and illustrates how they can be expanded to include broader functions to be outsourced by the clients.

EXHIBIT III-3

Business Operations Groups

Customer Focus	Organization Focus
Client Service	Payroll
Claims Management	Payables/Receivables
Direct Marketing	Bulletin Boards
Warranty Administration	Inventory Management
Order Processing	Engineering/Design

The list in Exhibit III-3 is not meant to be exhaustive, but to include all the functions discussed by the respondents to the INPUT survey. There is a natural split between the inner focus of the organization and its external interface with its client base. The internally focused functions should be designed to make the organization responsive to client needs also, but the interface is less direct in those cases.

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Responses to INPUT's survey indicate that user organizations are more prepared to turn over the customer focused operations to an outsourcing vendor than are internally focused organizations. The reasons for this center around the fact that new technologies can have the greatest impact on that interface and many organizations do not have the skills to implement these technologies. There is also some evidence that the internal staff may not have the necessary skills in human interaction. The person-to-person contact is critical, and vendor staffs are more thoroughly trained in this interface.

The use of automatic message routing in the client service environment, the increased use of imaging in claims processing and warranty administration, and the increasing use of electronic commerce in order processing all are good examples of how these applications of technology greatly improve the client interface.

The inner focused operations are often those in which the oldest systems and technologies are to be found in many organizations. As pressures mount to re-engineer the whole operation, there should be a change in attitude toward outsourcing these items also. The payback does not seem as apparent at this time, however.

C
Key Market Factors

Exhibit III-4 summarizes the market factors that will determine how rapidly the importance of business operations outsourcing increases in the years ahead. The long-term prospects are very positive, based on user intentions and perception, but the potential is even greater in the longer term if certain IT market trends develop along predictable lines.

EXHIBIT III-4

Key Market Factors

- Client/server platforms
- Electronic commerce
- Business re-engineering

The major trends that are affecting other segments of the IS market also will have a significant impact on the market for business operations outsourcing. The impact of those trends must be identified so that vendors can adjust their strategies accordingly.

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1. Client/Server

As client/servers emerge as the platform of choice in more applications areas, the question arises of what will happen to the mainframes. Though all sorts of dire predictions have been reported in the press, it is likely that some operations will still require mainframes as servers for the attached workstations and PCs. Large relational data base applications and those requiring extensive mathematical manipulation will still exist.

The mainframe of choice will be radically different from the currently operating stock of machines. They will most likely be massively parallel machines or other similar multistream processors, but they will still be the core of many operations. Thus, the ability to manage a data center operation effectively will continue to be a valuable asset to an outsourcing vendor.

Many organizations will probably overreact to the current downsizing drive and move applications to a client/server platform that are not suited to the task of high-volume processing. If action to correct this response must be taken, the continued availability of high-volume processing centers in the outsourcing vendor community will resolve the dilemma for many organizations.

2. Electronic Commerce

A strong argument could be made that EDI and the associated market for electronic commerce currently includes prime examples of business operations outsourcing. In some cases the user organization interfaces with one or more providers of EDI services (such as value-added network providers) but continues to manage the process internally. This trend is likely to increase as electronic commerce trading partners begin to cross industry lines. However, more examples are emerging of vendors willing to manage the entire information flow process for the client.

Another key issue that has already been a factor in the electronic commerce market is the lead trading partner issue. This issue is particularly apparent in the computer reservation systems run by airlines. For example, American Airlines runs the Sabre reservation system through its subsidiary, AMR International. A number of other airlines use that same system to book flight reservations for their own passengers. Periodically, there are complaints that the system is encouraging the booking of passengers on American Airlines' flights.

One solution to the problem would be to have a third party, not associated with any airline, run the system. Of course, under the current arrangement, Sabre is too profitable for AMR to consider that option. The airline industry may soon begin looking for a more desirable relationship. It is part of EDS's long-term strategy to provide this very capability. EDS has

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already acquired rights to Continental Airlines' reservation system, Source One, as part of its outsourcing deal with Continental.

As more complex electronic interchange networks develop, it will become apparent to many users that managing an electronic commerce operation is not a core competency. At that time, trading partners are likely to turn to their current providers or other outsourcing vendors for help. This should happen within two years.

3. Business Re-engineering

Some of the most eloquent proponents of business process re-engineering insist that the key to a successful re-engineering process is to start by asking the customers of the organization what they want from the organization.

That is certainly a valid basis on which to reassess an organization's operations. Is it 24-hour delivery, rapid problem resolution or instant access to account status that the customer wants? Acting on this analysis will lead to a thorough reappraisal of how the customer interface is handled in each organization.

As mentioned earlier, many of the processes that are good candidates for operations outsourcing are customer focused:

- Warranty administration
- Claims management
- Order processing
- Client service

As the process of re-engineering identifies these as needing complete redesign, the market for outsourcing these operations will expand significantly. Organizations will turn increasingly to vendors that have the skills to manage complex operations with high IT content when they need to make a radical transformation of their way of doing business.

Thus, the three strong trends that are impacting the IS market in general will have a positive impact on the demand for outsourcing business operations. This should allow traditional outsourcing vendors to expand their horizons significantly. There will be new opportunities for vendors who do not currently consider themselves IS outsourcing vendors but who do manage certain selective IS operations for many of their clients.

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User/Client Environment

The clients who currently use outsourcing vendors for business operations outsourcing are not easily identified. Many of them have not attached the outsourcing label to the operations they have chosen to have done by vendors. INPUT defines the outsourcing of business operations as turning over management of a business process with at least 30% IT content to a vendor. The IT content can be a client/server environment, applications software designed to more efficiently manage a client interface process such as complaint resolution, or some software and hardware combination that automates a labor-intensive process such as claims processing.

A
User/Client Requirements

To identify characteristics of importance to organizations considering vendors for business operations outsourcing, INPUT asked the respondents to rate a set of vendor characteristics on a scale of 1 to 5, with 5 being the most important. Exhibit IV-1 summarizes the responses in order of importance.

The most important requirement, according to the ratings, is that the vendor demonstrate experience in the prospect organization's own industry.

Thus, the prospect that is a bank wants the vendor to demonstrate knowledge and experience in the banking industry. This is in spite of the fact that the operation being outsourced—for example, accounting—may be common to all industries.

This response was contrasted to earlier surveys by INPUT on the vendor selection criteria of traditional outsourcing arrangements, such as systems operations and desktop services. In those responses, service level received the highest rating, followed by price. The vendor's references and reputation in the industry were ranked somewhat lower, but still in the top five items. (See *Methods of Approaching IS Outsourcing*, published by INPUT in 1992.)

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EXHIBIT IV-1

Business Operations Outsourcing— Important Vendor Characteristics

Characteristic	Rating
Experience in Client's Industry	4.7
Industry Reputation	4.1
Prior Outsourcing Experience	4.0
Financial Soundness	4.0
Prior Business Operations Outsourcing	3.9
Prior Work with Vendor	3.0
Recommendation of a Consultant	2.3

Lower on the scale, but grouped together nonetheless, are four related criteria: vendor reputation, financial soundness, prior business operations outsourcing experience, and prior outsourcing experience on the part of the vendor.

Vendor reputation and financial soundness are what some respondents referred to as "fuzzy" qualities. These qualities do not measure the technical or managerial capabilities of the vendor directly, but are important in determining whether the vendor is one with whom the client wants to enter into a partnership.

Prior experience in outsourcing in general and in business operations outsourcing in particular are considered important, but many of the respondents stated that the ability to develop a good working relationship with the vendor was of prime consideration.

As expected, the prospect recognizes that the arrangement with the vendor has to be one based on mutual trust and some assurance that the vendor has the resources and experience needed to be a reliable supplier of the IT systems and operations the client needs to run its business.

Prior experience with the vendor under consideration was not considered as important as other considerations, according to the respondents. Respondents agreed that they could satisfactorily assess the abilities of a vendor without having worked with that vendor before. This conclusion was reinforced with the response to the use of consultants to evaluate a vendor's abilities. It was rated lowest on the ratings scale, indicating again that user respondents feel they have the ability within their own organizations to evaluate vendors.

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B

Processes to be Outsourced

The business operations outsourcing contract that has attracted the most attention is the Andersen Consulting contract with BP Exploration UK. In this arrangement, Andersen Consulting has taken over the accounting function for the client. This contract is in its second year and the client reports complete satisfaction with the arrangement. In fact, BP Exploration is actively looking at outsourcing other business operations.

Outsourcing of business operations has been going on for some time, generally in services such as catering, landscaping and security. The new twist is that there are many business operations that have now become very IT intensive and are being considered prime candidates for outsourcing also. As mentioned earlier, INPUT considers an arrangement a business operations outsourcing contract if there is at least 30% IT content in the resulting activity.

The discussion of processes to be outsourced is based on two sets of observations derived from this research. In the course of the research, some examples of operations currently being outsourced were discussed by the respondents. In addition, both vendors and users were specifically asked which operations they might consider outsourcing next. Each item will be discussed separately.

1. Operations Currently Being Outsourced

a. Document Management

In discussions with the traditional outsourcing vendors, it was observed that some of them have found document management to be a lucrative source of revenue. The IT resources and the data processing and print management expertise of these operations are all strong points with the traditional outsourcing vendor. Exhibit IV-2 summarizes the document management services that were identified.

EDS, for example, has a document management portfolio called EVOLVE. It provides for the application of a series of technologies ranging from optical character recognition to laser disk output, along with the more traditional high-capacity print output. EDS has eleven locations in the U.S. from which it can provide the service, or the client can control its own processing at its site.

Document management has become a market thrust for EDS in which it can capitalize on the experience gained in such projects as the City of Chicago Parking Authority and the Apple Computer ADMACS project. In the former, EDS used imaging technology to eliminate the paper ticket

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under the violator's windshield and speed the hearing process significantly. The result was a 600% increase in fine collections. In the Apple case, EDS came in the middle of the project to convert all of Apple's engineering drawings to electronic form. EDS combined its imaging technology with its ability to manage the distribution of document images to multiple locations. The result was accessibility of the same document at all Apple sites, international as well as domestic.

EXHIBIT IV-2

Document Management Offerings

Vendor	System
EDS	EVOLVE
GENIX	TPM
ACXIOM	AMS (ACXIOM Mailing Services)
Xerox	Facilities management
Moore	Direct marketing services

The GENIX Group has a new service called TPM (Total Project Management) that offers customized solutions for electronic printing, direct mail and fulfillment requirements. This is a new service offering for GENIX that will be offered from its Pittsburgh facility. GENIX has been doing document management for a number of its outsourcing clients for some time. The great increase in demand for this service has led GENIX to offer document management separately. The tasks already being performed range from printing 50,000 billing statements per day for a Michigan utility to doing product fulfillment for a blue chip computer manufacturer.

ACXIOM is a relative newcomer to the outsourcing market whose background is fulfillment data base management. ACXIOM has expanded its AMS (ACXIOM Mailing Service) to include mailroom and lettershop operations as well as the fulfillment data base management activity that is its mainstay.

ACXIOM strives to build long-term relationships with its customers to enable them to reap the benefits of ACXIOM's services. Most contracts with customers reflect the company's commitment to its customers as shown below:

- A contract with Fulfillment Corporation of America (FCA), which includes outsourcing of FCA's entire data processing needs as well as management of the marketing data bases

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- An outsourcing contract with Direct Media, Inc. one of the largest list managers/brokers in the direct mail industry. ACXIOM provides list rental, merge/purge, private data base, public data base, National Change of Address (NCOA) correction service and list enhancement.

- ACXIOM also provides all mainframe processing functions to the M/A/R/C Group which provides targeted data base marketing analysis services and consulting to a wide range of clients.

Two other well-known vendors, not usually considered outsourcing vendors, are also providing document management services. Xerox, *the* document company, has been doing document management for many years and can manage the process completely for its clients, taking on the responsibility for its staff, facilities and output. Xerox can provide the staff and equipment to manage the document processing operations on the client site or do it remotely from a Xerox location. This has resulted in such success stories as saving a Southeastern health insurance provider $350,000 in annual postal costs.

- Reducing document production costs by more than 30% for a steel manufacturer that has a volume of more than 600,000 documents per month.

- Saved a medical equipment manufacturer $6,000 per month by taking over the copy center function of the organization.

Moore Corporation long ago expanded from its traditional business forms production printing and maintenance of mailing lists to providing expertise and software to conduct targeted market campaigns for its clients. Its Direct Marketing Services Division reports revenues of over $100 million for these services.

These are examples, not necessarily exhaustive, of a lucrative niche market that has all the characteristics of an outsourced business operation: high IT content and labor intensive yet critical to the client's organization. Many of these contracts are also long-term arrangements, though the concept of a fixed-price contract has not been used because of the variable nature of the operation over time.

b. Claims Management

Both the public sector and the insurance vertical markets have a great deal of claims processing activity, particularly relating to health services insurance. The Blue Cross/Blue Shield insurance providers and the Medicaid/Medicare payments administered at the state level are good examples of these activities. At the federal government level there are still other examples, such as the Federal Emergency Management Program and the Black Lung Program, both of which make disbursements to claimants.

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These claims processing arrangements have evolved in many cases from simply processing contracts to arrangements in which the vendor manages the claimant interface by providing the personnel for the customer service group that answers questions about claims. Some of the vendors are also the designated fiscal agents for the program they manage, actually disbursing the checks to settle claims, then being reimbursed by the client organization for this expenditure.

EDS and ISSC, among others, have been active in the health insurance vertical market, while CSC has effectively managed some of the long-standing federal programs for extended periods of time. Other vendors—SHL Systemhouse, for example—are also participating in this market, particularly in the entitlement programs, such as food stamps, administered at the state and local level.

c. Customer Service

One incident of a customer service operation being outsourced was identified in the course of this research. The Chevrolet Division of General Motors has retained EDS to manage and operate its customer service operation. When a Chevrolet owner calls in to the manufacturer with a question, a complaint or a problem, it is EDS personnel, specially trained to respond to these queries, who answer the calls and provide the answers. They are supported by a sophisticated client/server network designed to keep product data, order information and other such client issue information available on screen for the client service representative.

EDS also has other customer service agreements similar to the Chevrolet Division arrangement, one with Saab of America, another with Rockwell International's on-highway products group.

In a related situation, Computerland reports that many of its desktop services clients are expanding their help desk service to include Computerland staff when Computerland staff can bring unique expertise to the mix of personnel responding to customers' questions. This trend is also expected to continue.

Most organizations that deal with the public have such a help desk or customer service function as an integral part of their operations. These functions have evolved in the past few years as labor-intensive activities with a high IT content overlay to make them efficient. They also frequently have a high peak load that can cause particular management problems. We will see below that these are some of the key characteristics of operations that organizations consider prime candidates for outsourcing. It is likely that more of these operations will be outsourced in the future.

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2. Candidates for Business Operations Outsourcing

INPUT asked participants in the study to identify specifically which operations are to be considered for outsourcing in the future. Operations identified above were cited again (claims processing, customer service and direct marketing), but others were also mentioned. Some were merely processing operations (check processing), so were deleted from the list. Exhibit IV-3 lists some of these applications.

EXHIBIT IV-3

Candidates for Operations Outsourcing

- Payroll (2)
- Payables/receivables (2)
- Personnel management
- Information directories/bulletin boards
- Warranty programs
- Proactive customer contact

There are many candidates for operations outsourcing in the business environment. Payroll and payables/receivables have been the domain of the processing services vendors and specialized processors for a long time, but vendors and users alike are now considering them as just one more process to outsource to a vendor. They are considering incorporating payroll into the human resource function and payables/receivables into a broader logistics function.

Some of the other suggestions, such as personnel management and proactive customer contact, seem to touch on the most fundamental, traditional roles of the organization's business, but though they seem so obvious, they were mentioned nevertheless. Upon further discussion, it was discovered that these functions are considered specialist activities that can benefit from outside expertise, available more readily from a vendor than from internal staff.

Finally, the areas of information directories and bulletin boards reflect the increased availability of information for general consumption and the recognition of the fact that those systems do not run themselves. To be run efficiently, they need the resources of a competent expert in managing both data center and network operations.

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A variety of elements are considered important in the choice of the process to be outsourced. They have to be grouped in categories to extract the most information from the data.

A distinction was made between processes that are common to an industry versus those that are common to all organizations. An example of the former is claims processing; examples of the latter are payroll, general ledger and accounts payable/receivable. The hypothesis can be put forth that processes that are common to all business organizations are most likely to be outsourced because they cannot be used easily to give one organization a competitive advantage over another. In fact, according to their responses, the respondents were apparently more willing to outsource operations that were common to their own industry than more universal ones.

Because it is apparent that payroll, general ledger and accounts payable/ receivable are common to all organizations, INPUT investigated why the responses favored industry-specific operations. In fact, payroll is already outsourced in most instances, but is not considered by the user community to be a process normally outsourced.

The conclusion to be drawn, based on follow-up interviews, is that many business-wide processes are, in fact, already outsourced. Those common to a given industry are less frequently outsourced, but the fact that they are also performed by a firm's competitors does not make an organization more reluctant to outsource them.

A quote from BP Exploration on the question of what makes operations good candidates for outsourcing sums up the discussion well. "Do we need to do it? Is it something that only we can do? If not, there is a lot of expertise out there that can bring 'best practice' to bear on our problems." BP Exploration is currently outsourcing engineering services, provisioning of its drilling sites, network management, processing operations and accounting. The company indicated that it is looking at other operations as candidates for outsourcing.

C
Key Characteristics—Outsourced Operations

As part of INPUT's research protocol, the participants were asked to rank a number of characteristics as to their relative importance in determining if a business process is a good candidate for outsourcing. Exhibit IV-4 ranks the characteristics in order of importance.

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Both the categories "labor intensive" and "high technology content" got high rankings in the responses. The motivations for these two responses are different.

A labor-intensive process is a good candidate for outsourcing because of cost considerations. The outsourcing vendor is viewed as being able to reduce costs because of its management and procedures experience. These economies of scale are applied both through IT-oriented techniques that require a greater investment than most organizations can afford, and through management experience and methodologies for dealing effectively with large staffs performing data processing-intensive functions, whether help desk management, client service response or order fulfillment.

EXHIBIT IV-4

Business Operations Outsourcing—
Key Characteristics of Candidate Operations

Characteristic of Operation	Rating
Labor Intensive	4.1
High Technology Content	4.1
Common to Client's Industry	4.0
Periodic Peak Processing Requirement	3.7
Critical to Daily Operations	3.4
Common to All Business Organizations	3.2
High Transaction Volumes	2.9
Provides Competitive Advantage	2.8

The high technology content process is a good candidate for outsourcing because of the lack of internal skills in the client organization. In fact, the client will generally be receptive to paying more for the outsourced activity if it can be demonstrated that it improves service levels or customer response time or some other quality parameter that improves the client's image with its customer base.

When a process is common to an industry, it becomes a good candidate for outsourcing, according to the respondents. Such an operation is a commodity that is unlikely to distinguish one organization from its competition.

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There is no unique advantage to be gained by maintaining control over accounts payable or document management, functions that are common to members of the same industry. In fact these functions are common to all industries and performed the same way in most, if not all of them. In addition, it is easy for outsourcing vendors to become proficient at common, repetitive tasks.

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The item "periodic peaks" got a relatively high rating also, indicating that outsourcing vendors are still viewed as able to balance the demand for services because of the perceived economies of scale and the ability to manage variable work loads with a large staff. It is significant that when the distinction was made between peak volumes and high transaction volumes, the latter did not rate high as a reason for outsourcing an operation. Organizations are not uncomfortable with large processing loads *per se*, simply with the need to handle a fluctuating demand for processing capacity.

Two items in the list probed how the respondents felt about the criticality of the operation being outsourced. The responses indicated that being critical *per se* was not a strong deterrent to outsourcing an operation, but if the operation provided a competitive advantage to the client the organization was less likely to outsource it. This was the only response in which the vendors and the users differed. Three of the 12 vendor respondents felt that clients would even outsource operations that provide them a competitive advantage. Users, as might be expected, generally ranked the likelihood of outsourcing a competitive operation as one or two, though one user organization ranked it four.

In conclusion, there is a clear view in the market that business operations outsourcing is not a new concept, merely one that has been present in a fragmented manner. As the IT content of many traditional labor-intensive operations increases, these operations become even better candidates for management by outside vendors who can apply economies of scale and leverage new technology to do the task better.

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Vendor Perspectives and Plans

The established outsourcing vendors are already doing some business operations outsourcing, according to their responses to INPUT's survey. Of the 12 respondents surveyed, nine indicated that they already had some outsourcing arrangements that had the characteristics of business operations outsourcing. The proportion of their revenue derived from these arrangements ranged from 2% to 10% of their total outsourcing revenues, according to their estimates.

A
Current Vendors

To identify the perceived vendors for business operations outsourcing, INPUT asked user respondents to pick who they considered capable of taking over management of business operations. The responses to this question are shown in Exhibit V-1.

EXHIBIT V-1

User Perception of Business Operations—Capable Vendors

Vendor	Number of Mentions
EDS	7
Andersen Consulting	5
ISSC	4
CSC	3 (Federal)
Digital	2
SHL Systemhouse	1

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The comments that accompanied the naming of these vendors are worthy of recording, too. Note that CSC was specified as capable of managing federal government operations, but the respondents were not ready to say that this expertise would translate to the commercial market yet.

EDS was cited as able to manage business operations primarily by virtue of its sheer size. Several respondents said they did not know enough about the capabilities of Digital or Systemhouse to make a judgment about their suitability as business operations outsourcing vendors.

Two respondents added that a number of smaller regional companies specialize in certain niche markets and provide business operations outsourcing in their niches. Examples were cited, particularly in the health care/insurance area, for claims processing and home care management.

It appears that users are ready to outsource some non-core competency functions when they find vendors who can do it more efficiently than they can. They do not necessarily expect the traditional outsourcing vendors to be the only participants in that market, but feel that specialist firms and regional vendors may be the answers when these vendors demonstrate both a knowledge of the client's industry and a demonstrated ability to perform the task in question.

B
Vendor Strategies

Two elements of vendor strategy were identified by the respondents. As discussed in Chapter IV, some activity has been clearly identified in the areas of document management, claims processing and customer service. INPUT queried respondents as to what the next most likely operations to be outsourced are and when they, as vendors, are likely to see some activity in that area.

INPUT also investigated which vertical industries vendors felt were most likely to be most receptive to business operations outsourcing in the short term.

1. Next Opportunities

Exhibit V-2 tabulates the vendor responses about what the next outsourced operations are likely to be and when they will be outsourced.

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EXHIBIT V-2

Timing of Outsourced Operations

Operation	When	Number of Respondents
Customer service	now	3
Direct marketing	now	3
Claims processing	now	2
Bulletin boards	1-2 years	1
Warranty management	1-2 years	3
Personnel management	1-2 years	4
Payables/billing	1-2 years	6

The vendor responses only identified operations that are currently being done or likely to be outsourced in the next two years. INPUT's questionnaire did not restrict vendors to that timeframe, however. Many of the respondents indicated that they only set their sights to that timeframe and expect the market to change significantly thereafter.

Both direct marketing and customer services are operations that INPUT identified as being outsourced now. All vendors thought these functions were ready to be outsourced now, not just vendors who currently outsource these activities.

There were many candidate operations for outsourcing in the next two years, according to the survey respondents. Payables and billing functions are now often handled by outside specialists, but there is still a significant labor content retained by the client organization. The consensus is that more of these functions could be easily turned over to a vendor for management.

Personnel management is an interesting operation to outsource. Some aspects of personnel management—payroll, incentive programs and employee benefits administration—are handled by specialists. The vendors felt that there would be a demand to outsource the entire set of functions as a single operation in the coming years.

Warranty management operation is really an outgrowth of the customer service activity that has begun to appear in companies such as Saab and Chevrolet. It does not only apply to consumer products, however. The aircraft industry is another natural target for application of the warranty administration activity because its parts warranty system is extremely critical to both aircraft safety and cost control.

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The electronic bulletin board suggestion was surprising. It reflects the increased presence of this electronic medium as a viable communications vehicle. The success of the current commercial bulletin boards has been tracked in the processing services service mode by INPUT and will continue to appear there. The respondents who suggested this item felt that there was a market for the management of private bulletin boards by vendors for specific organizations or special-interest groups.

One respondent probably summed it up best with the following statement: "Any operation is a candidate that is not related to the client organization's core business. That means that everything from customer service to internal training and education should be outsourced."

2. Vertical Industry Penetration

The vendors were also asked which vertical industries they thought were most receptive to business operations outsourcing. The responses are summarized in Exhibit V-3.

EXHIBIT V-3

Industry Receptivity to Operations Outsourcing

Industry	Number of Mentions
Health Services	10
Insurance	8
Retail	6
Banking/Finance	6
State and Local Government	3
Manufacturing	2
Utilities	2

The health services and insurance markets are viewed by vendors as the most receptive to outsourcing of business operations. Discussions with participants in this study indicated clearly that the claims processing function in both of these industries is the targeted operation. It was described as being both labor intensive and with a high IT content, both characteristics that make the operation a good outsourcing candidate. The intense pressures on the health care services industry also were cited as a reason to encourage business operations outsourcing.

The retail and banking/finance markets received a large number of mentions also. The comment made for both of these industries was that there were many functions that were not core competencies of the client organizations that made good candidates for outsourcing.

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Examples of such operations include order placement and fulfillment in retail, and check processing and lockbox operations in banking and finance. These last two are already outsourced to specialized processors in many cases, but vendors felt they would be incorporated into more inclusive outsourcing arrangements in the future.

One overriding reason was cited for making most of these vertical markets good candidates for outsourcing business operations. It is likely that all vertical markets have the same subset of operations that are not core competencies. When this motivator is coupled with financial constraints or the need for predictable IS costs or some cross-organization capability such as lockboxes, the impetus is strong enough to make the prospects seriously consider outsourcing.

3. Vendor Perspectives

In an open-ended survey question, vendors were asked what they need to do to encourage users to do more business operations outsourcing. The usual comment—that the vendor and client relationship has to be a partnership—was voiced, but some other, more insightful comments follow:

- "The buyer has to recognize that it can be done. The industry needs several good examples of success stories."
- "The vendor must deliver more than performance. The user must see commitment on the part of the vendor. That often means that the vendor has to demonstrate he will do whatever it takes to get the job done, regardless of the contract terms."
- "The user must be assured a good financial return on his decision to outsource. For that, the vendor has to deliver on promises."
- "The vendor must in some way minimize the emotional attachment to certain operations so that the user will consider outsourcing them."

The themes are user education and willingness to perform beyond the terms of the contract when necessary. This is a new business environment for many vendors.

In another open-ended question, the vendors were asked why the user organization was motivated to select an external vendor to perform the operation at all. The responses are revealing:

- "The users want to make a 'technical infusion' into their organization and do not have the technical skills or do not want to make the capital investment (sometimes both)."
- "The learning curve for their staff to learn a more efficient process is too steep, so they turn to a vendor."

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- "They decide they can get a better return on their assets by using an outside vendor."

Several vendors indicated that they thought the motivation was often the need to automate or improve the old system. One respondent had a different perspective on this issue, however.

- "Clients are technologically literate but don't want to make the required investment in equipment, staff and time."

Finally, there were some general comments made dealing with what skills the vendor must provide. These were not only technical and management skills, though several vendors did support the user viewpoint that industry knowledge is necessary.

- "The user wants responsiveness. Do the unexpected to solve the problem."
- "Develop skills in business modeling and analysis methodologies to build credibility with the client and understand the business better."
- "Management consulting skills in the vendor organization builds credibility for the vendor."

C
Competitive Environment

As mentioned early in this chapter, certain traditional outsourcing vendors are considered by the user community to be fully capable of managing business operations. EDS, Andersen Consulting and ISSC in particular were mentioned several times.

When the respondents were asked if there were any other vendors they could identify who were able to outsource business operations, no names were volunteered. Most respondents indicated that they did not know the potential market players well enough to make a judgment.

Yet INPUT's investigations did find a number of nontraditional vendors who were indeed doing some business operations outsourcing as defined by INPUT. These were primarily document management firms currently, but the field will expand.

EDI and electronic commerce is considered by many to be an outsourced business operation now. It is a business process with high IT content. If done traditionally, it would have high labor content also, and is critical to an organization's success. It has the additional complication that it usually involves the cooperation of a number of trading partners, which complicates the management process significantly.

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GE Information Services (GEIS) and Advantis are significant players in that market as service providers now and are fully able to expand their operations management capability to include peripheral operations related to electronic commerce. Advantis has the additional advantage of being closely allied with ISSC, so it has a strong reputation in the more traditional outsourcing marketplace to enhance its position.

Some of the industry specialists such as Policy Management Systems and Shared Medical Systems are doing some business operations outsourcing in their claims management practices. They do not show any tendency to be applying this core competency to other industries. They appear to have sufficient opportunities in their niche markets to keep them busy.

The concept of business operations outsourcing is still a relatively untested one, even in the opinion of the users who have in fact included some of these operations in their outsourcing agreements. The vendors indicated that they are still struggling with explaining to the prospect base what it is and how it differs from systems operations. The vendors are also unanimous in their assessment that the outsourcing of business operations will be much more common in a year or two.

All current vendors expect to participate in this market to an increasing degree. Some have already isolated certain operations in which they will provide core competencies. Others are still reacting to needs as they arise.

New players will certainly emerge, probably from the ranks of processing services vendors. It is likely that the market for business operations outsourcing will be spread, if unevenly, between the traditional outsourcing vendors and these emerging vendors. The shift has already begun.

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Case Studies

A time proven method of investigating a new area of interest is to provide case studies to illustrate certain aspects of the field. In its first study of the business operations component of the outsourcing market, this is a particularly valid approach. The three case studies that follow are all different. They demonstrate how different vendors provided solutions to client problems. The problems are not new. The solutions represent the application of "best practice" methodology to existing problems. In these cases the vendors leveraged their own experience, software or management approach to bring a better solution to the clients than the ones they could implement on their own.

A

Case Study 1 - General Motors, Chevrolet Division

1. Introduction

The outsourcing of business operations can take on as many forms as there are business functions to be outsourced. As mentioned earlier, operations common to all industries and those that do not interact with the clients of the firm tend to be good candidates for outsourcing.

The situation described in this case does not follow that pattern at all, however. In fact, it represents the outsourcing of a function vital to the organization's client relations. Chevrolet Division of General Motors has outsourced the operation of its customer service desk to EDS. The skeptics may say this is an operation that was kept in the GM family, one division to another. This case was selected only because it has been in place for some time. In fact, EDS has two other outsourcing arrangements with non-GM organizations which involve the customer service operation also.

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2. Background

The Chevrolet Division was reevaluating its customer assistance operation seven years ago. They had a regional system serving the U.S. customer base. The staff was located in 44 zone offices and provided local support to customers in the local geographic areas. The proposal was made to centralize the staff in Detroit and improve the efficiency and the management of the operation.

In the process of reevaluating the operation, other issues were also raised. New operating procedures were instituted and new equipment was recommended in the redesigned environment. It was at this time that the outsourcing of the entire operation was first considered, according to Dave Ellingham, Manager of Chevrolet Division's Customer Assistance and Technical Assistance Department.

3. Motivation for Outsourcing

Chevrolet had very good reasons for looking to a vendor to outsource this operation.

First, they had a headcount problem. Many managers in large corporations are constantly struggling with the problem of keeping within the guidelines on headcount limitations laid down by corporate and still getting the work done. His operation was certainly labor intensive but he had to work within a head count limitation that made it difficult to balance service and staffing.

Furthermore, the profile of the people who would be good candidates to operate in the customer service environment did not match the profile of GM employees, according to Dave Ellingham. Employees with years of GM experience did not want to stay in the customer service environment They also came burdened with a large GM benefits package.

The customer service function was also becoming more technology intensive. Client data, technical data, status information, all had to be at hand for the customer service representative to function properly. The judicious application of technology to these problems was something management at the Chevrolet Division felt EDS could provide.

Ted Ryan, EDS Vice President responsible for the Centers of Service, affirmed that the customer service function is one that can be greatly enhanced by the effective application of technology. EDS has successfully applied this principle to a variety of business operations for clients in the past two years.

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The communications problems associated with running an efficient and responsive centralized customer service organization needs the services of an expert in telecommunications. Chevrolet had experienced problems in the past in relying on their communications carrier to solve these problems, according to Dave Ellingham. EDS had the demonstrated expertise and experience to address the needs of the Customer Assistance Department.

4. Outsourcing Arrangements

Dave Ellingham and his associate in the Customer Assistance organization, Bob Johnson, are Chevrolet Division employees. They provide the management function and assure that Chevrolet standards are maintained. There is a full-time EDS account manager assigned to the center to provide liaison and management support.

Though Chevrolet feels the number of staff assigned to this function is proprietary information, they volunteered that most of the rest of the staff are employees of EDS. They are trained by Chevrolet to understand and resolve the callers' questions and inquiries.

Also reluctant to specify the number of calls that are processed daily, they did indicate however that there has been a net increase since the new arrangement was put in place.

5. Benefits to Client

The Chevrolet Division of General Motors has reaped the benefits outlined in Exhibit VI-1 from having outsourced its customer services organization to EDS.

EXHIBIT VI-1

Benefits of Outsourcing Customer Services

- Significant reduction in cost of operations
- Elimination of the turnover problem
- Procedures and equipment are being upgraded and revised

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Dave Ellingham was asked what else he would consider outsourcing if he had the option to do so. His response was that he could envision the outsourcing of proactive customer contact as a logical next step. The same organization that handles incoming customer calls could be applied to making outgoing calls to customers to promote dealer services, gather market information or promote special offers.

Ted Ryan of EDS was very specific about the benefits that outsourcing customer services can have for the organization. "What is the number one problem facing the management of any customer service organization? Turnover. The typical in-house customer service desk has a very high turnover rate because it is a difficult job. No one wants to stay there long."

"EDS offers the client a customer service organization that is stable and effective. How do we do it? We hire employees directly into the customer service organization, train them well and identify a career path that takes them into another position in EDS after two years. We are able to keep turnover rate at 5% or less in this way. That is a turnover rate that will make any customer service manager take notice," commented Ryan.

6. Summary

At first glance, customer services seems like an unlikely operation to outsource to a vendor because of the close interaction with the client organization's customers. There are compelling management reasons to do so however. As we have seen, cost advantages, the application of technology to create a more efficient environment and a more stable work force are three highly prized benefits cited in this case.

There are many such business operations that can be outsourced. They range from direct marketing to order fulfillment and shipment tracking. Though they all interface with the customer of the client organization, they can benefit from several advantages the outsourcing vendor brings to the party. These are:

- the application of technology makes the process more efficient and responsive to the customer.
- the same technology can be applied to track customer related activity more accurately and thus provide a much better market research base.
- the daily problems of dealing with a work staff with traditionally high turnover becomes a matter of dealing with a single vendor account manager.
- cost advantages can be realized because the vendor can provide a lower overhead rate structure to the client.

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B

Case Study 2 - Guideposts Associates, Inc.

1. Introduction

Guideposts Associates, Inc., located in Carmel, NY, is a non-profit publisher of inspirational magazines and books. Its flagship publication, Guideposts, is the twelfth largest mass circulation magazine in the U.S. with 4 million subscribers. In addition, Guideposts Associates, Inc. markets such products as greeting cards, condensed books and other continuity products (subscribers sign up to receive multiple volumes of the product over a number of months).

The company has been in operation since the 1970s. At the start, its primary data processing function was maintaining its ever-expanding mailing lists. The company found it needed to turn that asset—now a 13 million name customer file—into a marketing data base as it broadened its product line.

2. Background

Guideposts was forced to change from its dependence on the single-file in-house system, used to fulfill magazine and single copy book fulfillment orders, when it found the continuity products business expanding. The company now has more than a dozen such products and that market is still expanding.

The marketing staff needed more purchase information than was currently available. They needed such information as name-source data, number of purchases or total dollars spent across all product lines for each prospect.

After a frustrating search for a software product that would do all this, it was decided Guideposts would create the product itself, according to Rocco Martino, Guideposts' operations vice president. The resulting product, GS2000, was built on a hierarchical data base structure and provided the required summary data about customers and details about their purchasing history. It was first deployed in 1987.

As currently deployed, the system carries almost 400 variables on each customer. Guideposts states that the product did not have an immediate impact on the company's operations, however. "It wasn't until 1990 or 1991 that we had compiled enough history to really make the marketing data base work for us," states Martino.

In 1989, Guideposts entered into an outsourcing relationship with Acxiom to reduce processing costs and take advantage of the synergy between its own proprietary product and Acxiom's data base management product, RelationBase.

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Acxiom, in turn, identifies its entry into the outsourcing business with the assumption of all magazine fulfillment data processing functions for Guidepost Associates in 1989. At that time, the GS2000 product was licensed to Acxiom, also further increasing the tool set it could provide to its own processing clients.

3. Motivations for Outsourcing

When Guideposts entered into its outsourcing arrangement with Acxiom in 1989, it was seeking to reduce costs for its data processing operations as a primary benefit. It also had become convinced that Acxiom's direct marketing software, Relation Base, would enhance the publisher's ability to manage its marketing data base even more effectively than it could do on its own.

4. Outsourcing Arrangement

Guideposts currently has an eight-year agreement with Acxiom that provides Guideposts with the data processing capacity they need to operate both a mass circulation magazine and a fully diversified subscription products company.

The processing requirements are rigid. Guideposts rebuilds and updates its data bases every month in a process that spans a 72-hour period. The company relies on the proven data center management skills provided by Axciom to ensure the process works the first time.

"If for some reason there's a problem in building that data base, you could lose two to three days in the process, and a 72-hour build becomes a six-day build," stated Mr. Martino in describing the value of Axciom's expertise.

Axciom states that using a proprietary system of "attached processors" reduces operating costs and improves reliability by distributing tasks to linked processors.

5. Benefits to Client

According to a company spokesperson, financial benefits that amount to a 20% cost reduction in the data processing expenses are only one of the benefits Guideposts has realized in its outsourcing arrangement with Acxiom.

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EXHIBIT VI-2

Benefits of Outsourcing
Marketing Data Base Processing

- Experience a 20% cost reduction
- Provide time for business problem focus
- Provide new revenue generating opportunities

The ability to focus on core business problems and not to be preoccupied with the management of information technology is as important as the cost savings to the publisher.

The Acxiom supported software (GS/2000 and RelationBase), in addition to contributing to the reduction in overall data processing costs, has provided the opportunity to institute innovative ways to enhance revenue, thereby bringing two classes of financial benefits to the company.

6. Summary

The phrase "partnership" is often touted as the real relationship that must exist between outsourcing vendors and their clients if the operating arrangement is to work well. Many times this is an overused phrase. In the Guidepost/Acxiom environment, however, there does appear to be a true partnership.

Both parties to the agreement have benefited, and not only financially. Guideposts has seen an operating cost reduction and gained the expert capabilities at data center operations that Acxiom can provide.

Acxiom has acquired a license for the GS2000 product that enhances the services they can provide to their other clients in the marketing data base management area. They have also gained a valuable new reference client which can build their credibility in the fulfillment and list management market.

Acxiom seems particularly adept at forging close partnership arrangements with its clients. After the $200 million Trans Union contract was announced, the CEO of Trans Union was invited to join the board of Acxiom. The contractual relationship with Maritz, another client, includes joint marketing and business development activities by the two companies, initially focused on the telecommunications, automotive and pharmaceutical industries.

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C
Case Study 3 - City of Orlando

1. Introduction

In 1991, the city of Orlando, Florida moved to a new city hall, a nine story building with ample room for over 600 employees, and such amenities as park benches and a plaza with a fountain for visitors.

This was a welcome change for everyone, employees and citizens alike, but another less noticeable change also took place at the same time. Orlando decided to outsource its document production operations at that time to bring that process in line with the city administration's new image.

2. Background

In the old arrangement, the city owned a print shop with its own print equipment and also rented about 50 copy machines for the use of individual departments. The print shop was actually half a mile from city hall and employed seven people. Most of the print requirements, from notepads to calendars to budget documents, were prepared by the print shop. As the city grew, the load on the print shop grew also. Bob Chamberlin, the former print shop supervisor, states: "We were becoming overwhelmed. Budget constraints and a constant need to expand were making it difficult for us to meet the demand."

The remote location of the print shop was a factor also. Any rush job had to be accompanied to and from the site by a city employee, who had to wait on site until the job was finished.

3. Motivation for Outsourcing

Orlando officials began to examine the alternatives available to them to solve the print shop problem as soon as they knew they were moving to a new city hall. Outsourcing was considered, but officials felt uncomfortable turning over control of the print shop to a vendor.

Richard Nagel, Orlando's purchasing agent, was responsible for soliciting vendor bids and evaluating the resulting proposals. "We wanted a company that would give us a smooth operation," recalls Mr. Nagel. " (The vendor's) organization and procedures were key points with us."

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4. Outsourcing Arrangements

After evaluating several proposals, Xerox Business Services was selected in late 1991 to provide the printing requirements for the city. Under the arrangement, Xerox personnel provide both reproduction services and maintenance services for Orlando. This staff handles all printing needs, provides two walk-in copy centers, one on the city hall premises, as well as maintenance for 60 copiers located in various locations around the city hall.

The copy center was installed and staffed in the new city hall before the employees moved in, so it was ready to go from the first day in the new location. "There was no going back after that," recalls Dick Nagel. "I just hoped it would be a success."

City officials meet with representatives of Xerox four times per year to discuss how the arrangement is working and discuss changes to improve the service. Nagel says: "It's much easier to discuss complaints with an outside company than it was when it was our own employees."

5. Benefits to Client

The results have been evident. These are summarized in Exhibit VI-3. Financially the city estimates that it saved as much as $100,000 in 1992. The city's budget director reported large copy jobs that used to cost $8,000 now cost only $4,000. There are many examples of such savings in the city's departments.

EXHIBIT VI-3

Benefits of Outsourcing Reproductions Operations

- Savings of $100,000 per year
- Cost savings to 50% on individual projects
- Technology upgrades are automatic
- On-site copy center with backup

Another recognized benefit is that city managers no longer are concerned about investing much needed funds to keep pace with new technology. Xerox Business Services is responsible for providing the appropriate technology and updating that technology to meet the city's expanding needs. Their business incentive is to leverage technology to best service the account at the lowest cost to Xerox as well as the City of Orlando.

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6. Summary

The city of Orlando, in selecting Xerox Business Services to provide their reproduction services, chose a vendor with a long history of outsourcing in the document management area. Xerox claims to have about 1,000 installations in the U.S. that they are managing. In addition, they maintain 60 Xerox-owned service centers across the nation to provide backup and overflow support for those installations as well as special project activity for special events.

The classic reasons for outsourcing IT services apply in this environment also. The reasons include demonstrated cost savings as well as the other less quantitative reasons. These include "letting the experts do it" more effectively, the elimination of the need for capital investment and the predictability of the monthly reproduction expenses under an outsourcing arrangement.

Orlando represents a growing trend in which state and municipal agencies are coming to recognize the advantages outsourcing brings them. They are faced with the need to provide more services, more efficiently while reducing their budget expenditures in the face of reduced revenues and federal slowdown of funds. The use of outsourcing to take on business operations such as the reproduction activity will make them more receptive to outsource their entire data centers in the future.

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Vendor Questionnaire

OUTSOURCING INFORMATION SYSTEMS PROGRAM

BUSINESS OPERATIONS OUTSOURCING

VENDOR QUESTIONNAIRE

Good morning (afternoon). This is _____. I'm calling from INPUT, a leading market research firm in the field of information services.

INPUT needs your assistance in identifying issues and market potential for the area called business operations outsourcing. INPUT's definition of business operations outsourcing is the turning over to vendor management of an entire functional process in an organization, either financial, human relations or some other function. You need not be engaged in business operations outsourcing currently to respond to our survey.

We appreciate your assistance and, in return, we would like to send you a copy of the executive overview of the report when it is completed.

The questions will take about 15 minutes. Is this a good time to discuss this or would you prefer to schedule a specific time for me to call back?

_____ Now (Go to Question 1)

_____ Later _____ (time and date)

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1. Which of the following IS functions do you provide to clients as part of an outsourcing agreement? What percent of your total outsourcing revenue does each represent?

	Function	% of Total
a. Processing Operations	_____	_____
b. Applications Maintenance	_____	_____
c. Applications Development	_____	_____
d. Network Management	_____	_____
e. Desktop Services	_____	_____
f. Business Operations	_____	_____

(If response to question 1(f) was yes, ask the following question; otherwise go to 4)

2. You indicated above that you already do some business operations outsourcing. What functions are included in these agreements and what is the IT content of those functions (%)?

Function	% IT Content
_____	_____
_____	_____
_____	_____
_____	_____

3. In your opinion, why do your clients outsource these functions?

_____

_____

_____

4. Do you expect your organization to provide any other outsourcing operations in the next five years? Which ones?

	Yes	No
a. Processing Operations	___	___
b. Applications Maintenance	___	___
c. Applications Development	___	___
d. Network Management	___	___
e. Desktop Services	___	___
f. Business Operations	___	___

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5. In general, do you see business operations outsourcing increasing among your outsourcing clients? If so, which functions are candidates and when will they be outsourced?

No _____ (go to 7)

Yes _____

Function	When

6. What makes these operations good candidates for outsourcing?

_____

_____

_____

7. Are any industry segments particularly prone to business operations outsourcing? If so, which are they and why are they prone to business operations outsourcing?

Industry	Why?

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8. What do you as a vendor emphasize to encourage a prospect to select your company to perform business operations outsourcing? Please rate the following factors on a scale of 1 to 5, with 5 being the most important.

	Circle One
Experience in your industry	1 2 3 4 5
Prior experience in outsourcing	1 2 3 4 5
Prior business operations outsourcing experience	1 2 3 4 5
Prior work with your company	1 2 3 4 5
Reputation in the marketplace	1 2 3 4 5
Recommendation from a consultant	1 2 3 4 5
Financial soundness	1 2 3 4 5
Other _____	1 2 3 4 5

9. The following is a list of characteristics of a business operation. How important is each of these, on a scale of 1 to 5, in making the process a candidate for outsourcing?

Process	Circle One
Common to organizations in your industry	1 2 3 4 5
Common to all business organizations	1 2 3 4 5
Labor intensive	1 2 3 4 5
High technology content	1 2 3 4 5
High transaction volumes	1 2 3 4 5
Periodic peak requirement	1 2 3 4 5
Critical to day-to-day operations	1 2 3 4 5
Provides competitive advantage	1 2 3 4 5
Other _____	1 2 3 4 5

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10. What skills or capabilities are particularly important to a vendor in the business operations outsourcing market?

_____

_____

_____

_____

11. What do vendors need to do to encourage users to do more business operations outsourcing?

_____

_____

_____

_____

Thank you for your cooperation on this project. If I can verify your address, I will make certain you get a copy of the executive overview of this report when it is released.

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User Questionnaire

OUTSOURCING INFORMATION SYSTEMS QUESTIONNAIRE

BUSINESS OPERATIONS OUTSOURCING

USER QUESTIONNAIRE

Good morning (afternoon). This is _____. I'm calling from INPUT, a leading market research firm in the field of information services.

INPUT needs your assistance in identifying issues and market potential for the area called business operations outsourcing. INPUT's definition of business operations outsourcing is the turning over to vendor management of an entire functional process in an organization, either financial, human relations or some other function. You need not be outsourcing a business operations currently to respond to our survey.

We appreciate your assistance and, in return, we would like to send you a copy of the executive overview of the report when it is completed.

The questions will take about 15 minutes. Is this a good time to discuss this or would you prefer to schedule a specific time for me to call back?

_____ Now (Go to Question 1)

_____ Later _____ (time and date)

1. Has your organization outsourced any of its information systems operations to a vendor?

   Yes _____
   No _____ (Go to 3)

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2. Which of the following IS functions have been outsourced to a vendor and who is the vendor?

Function		Vendor
a. Processing Operations	_____	_____
b. Applications Maintenance	_____	_____
c. Applications Development	_____	_____
d. Network Management	_____	_____
e. Desktop Services	_____	_____
f. Business Operations	_____	_____

(If the response to 2f was yes, ask the following question; otherwise go to 5).

3. You indicated above that you already outsource some business functions. What are they and why were they outsourced?

Function	Why?
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

4. Again, let's consider the business functions you have outsourced.

   a. What criteria did you use in selecting a vendor?

_____

_____

_____

_____

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b. Who was selected and why?

_____

_____

_____

_____

c. What was the contract value and length? $_____

_____ years.

d. How do you manage the contract?

_____

_____

_____

5. Do you plan on outsourcing any (other) business operations in the next five years? If so, which functions are candidates and when will they be outsourced?

No _____ (go to 6)

Yes _____

Function	When
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

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6. The following is a list of characteristics of a business operation. How important is each of these, on a scale of 1 to 5, in making the business operation a candidate for outsourcing?

Process	Circle One
Common to organizations in your industry	1 2 3 4 5
Common to all business organizations	1 2 3 4 5
Labor intensive	1 2 3 4 5
High technology content	1 2 3 4 5
High transaction volumes	1 2 3 4 5
Periodic peak requirement	1 2 3 4 5
Critical to day-to-day operations	1 2 3 4 5
Provides competitive advantage	1 2 3 4 5

7. In your opinion, which of the following vendors have the capability to take over responsibility for business operations? (Check all that apply.)

EDS _____ ISSC _____

Digital _____ CSC _____

Andersen _____ Systemhouse _____

Other _____

_____

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8. What would you look for in a vendor to whom you outsourced your business operations? Please rate the following factors on a scale of 1 to 5, with 5 being the most important.

	Circle One
Experience in your industry	1 2 3 4 5
Prior experience in outsourcing	1 2 3 4 5
Prior business operations outsourcing experience	1 2 3 4 5
Prior work with your company	1 2 3 4 5
Reputation in the marketplace	1 2 3 4 5
Recommendation from a consultant	1 2 3 4 5
Financial soundness	1 2 3 4 5

9. In your opinion, what do you think would increase the appeal of business operations outsourcing for prospect organizations?

_____

_____

_____

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- Software and Services Vendors
- U.S. Federal Government
  - Procurement Plans (PAR)
  - Forecasts
  - Awards (FAIT)
- Commercial Application LEADS

CUSTOM PROJECTS

For Vendors—analyze:

- Market strategies
- Product/service opportunities
- Customer satisfaction levels
- Competitive position
- Acquisition targets

For Buyers—evaluate:

- Specific vendors
- Outsourcing options
- Market opportunities
- Systems plans
- Peer position

OTHER SERVICES

Presentations to user groups, planning meetings, etc.

Acquisition/partnership searches

Newsletters

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